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- 1 - D/OER
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FORM NO. 241 1 FEB 55  REPLACES FORM 36-8 WHICH MAY BE USED.  (47)

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## The Impact of Oil Price Hikes on Selected Less Developed Countries

### Overview

Prior to the energy crisis, the economic outlook for several major US aid recipients was fairly bright. In the case of South Korea, 1973 was a banner year, while Thailand, the Philippines, and Turkey each recorded substantial economic gains. In all four cases, the outlook was for another good year in 1974. In South Vietnam and Cambodia, war-related problems continued to cause economic difficulties. Chile faced serious economic trouble, including an intractable balance-of-payments problem inherited from the Allende government. Some improvement in Chile's economic performance was anticipated in 1974.

Energy-related problems will cause difficulties for all seven countries this year. The immediate problem will be substantially higher costs of oil imports. In the case of South Korea, oil import costs will increase at least $700 million in 1974, to about $1 billion -- assuming no growth in the volume of deliveries. The rise in cost equals 20% of total exports last year. The other countries face smaller increases in oil import costs, but the amounts are substantial relative to the size of their economies and financial resources.

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The non-oil import bill for these countries also will tend to increase considerably this year as a new round of inflation hits their major trading partners, including other LDCs. Although most of the aid recipients are agricultural countries, several of them must import large amounts of food and other agricultural products. Prices of these commodities are likely to increase again this year because of continuing tight world supplies. Chile will be especially hard hit in this regard, since about one-third of its non-oil imports are foodstuffs. Imports of consumer goods and capital equipment will carry higher price tags as well.

The ability of several of the countries to boost exports will be hindered by the expected sharp economic slowdown in major industrialized countries. Real output in these countries will expand very slowly, and their demand for raw materials is likely to stagnate. Japan's raw material import requirements this year probably will decline sharply. As a result world market prices for some commodities exported by LDC's may well be dropping while their import prices are rising. Beyond this, the general weakening of world-wide business confidence may well lead to a temporary slowdown in private investment flows into LDCs.

South Vietnam, Cambodia, and Chile will be least capable of handling the financial burden stemming from the oil price hikes. All three were having serious balance-of-payments problems before the crisis. Neither their economies nor their international financial positions are very resilient. South Vietnam and Cambodia will face problems simply because of higher oil costs -- in the case of Cambodia, security problems will make it difficult to get oil. Chile's difficulty will stem primarily from a possible sharp downturn in export earnings. All three countries depend heavily on foreign funds to maintain economic stability.

South Korea and the Philippines will have smaller financial problems. Both countries face foreign exchange constraints, but South Korea probably can avert a serious balance-of-payments problem as long as private capital inflows continue at near normal levels If foreign aid flows continue at recent levels, the Philippines probably can manage this year by drawing down reserves.

Thailand and Turkey are in the best position to cope with problems arising from higher oil prices. Turkey currently has foreign exchange reserves equal to a year's imports and possibly could achieve a small balance-of-payments surplus in 1974. Despite the increased oil bill, Thailand probably will still have reserves equal to at least three months' imports by the end of this year.

South Korea

Higher oil prices in 1974 will boost South Korea's oil import bill by at least $700 million. Total oil import costs will amount to about $1 billion, equivalent to almost one-third of last year's export earnings. The increased oil bill will put a heavy but probably not critical strain on South Korea's foreign reserve position. Domestic economic activity will continue strong in spite of some problems arising from the oil price hikes.

Although South Korea's balance of payments has improved in recent years, it is still vulnerable. Exports, largely light manufactures, grew by 80% in 1973, to $3.3 billion, and imports increased rapidly, to $4.1 billion. The deficit was more than offset by private capital inflows, largely from the United States, and by foreign aid. As a result, foreign exchange reserves have been rising. Reserves reached $1 billion at the end of 1973, equal to about three month's imports.

Increased oil import costs plus anticipated increases in non-oil imports, especially foodstuffs, will boost the value of South Korea's foreign purchases by at least 30% in 1974, to an estimated $5.3 billion. A substantial portion of Korea's imports consist of machinery and equipment, and prices for these goods are likely to increase appreciably.

The value of grain imports should increase substantial due to higher prices.

While import costs will rise sharply, South Korea's export growth will slow to perhaps 20% in 1974 -- about half the average rate of the previous five years. The bulk of Korean exports consist of light consumer goods, foreign demand for which will weaken this year. Almost two-thirds of the growth in South Korean exports in 1973, for example, went to Japan, but the Japanese economic growth is expected to slow dramatically. Sales to the US market will increase, but not enough to increase total exports as rapidly as in recent years.

Given the outlook for imports and exports, South Korea's current account deficit will increase from $400 million in 1973 to an estimated $1 billion in 1974. The deficit will be offset to some extent by official and private capital inflows. During 1973, capital inflows reached an estimated $800 million. The problem is that world-wide business confidence has already been shaken by the energy crisis, and this could lead to a decline in private investment inflows to Korea. If capital inflows about match last year's level, Seoul can probably cover its payments deficit by drawing down official reserves.

South Korea's unprecedented real growth in GNP of 17% in 1973 was largely the result of growing exports, and if their expansion slows, so will the rate of economic growth. Beyond this, some weakening in domestic demand is likely because of the contractionary effect of higher oil import costs. Should demand fall sharply, many firms would face bankruptcy within a fairly short period because they depend so heavily on borrowing to finance their operations. All things considered, we judge that South Korea's real growth in 1974 will probably slow to 5% to 7% because of the likelihood of slower export growth.





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Turkey

Higher oil prices in 1974 will boost Turkey's oil import bill by at least $300 million. Total oil import costs will amount to about $600 million, equivalent to about half of last year's export earnings. Turkey should be able to handle the rise in oil import costs without great difficulty this year.

During the past two years, Turkey's balance of payments has improved significantly. Exports, largely agricultural, grew by 54% last year to $1.2 billion, because of higher world commodity prices. Imports also increased sharply, reaching $2.0 billion. The deficit was more than offset by remittances from Turkish workers in Europe plus capital inflows. As a result, Turkey's foreign reserves increased dramatically. By October 1973, they totaled $2.2 billion, equal to a year's imports.

Increased oil import costs plus anticipated increases in non-oil imports will boost the Turkey's 1974 foreign purchases by an estimated 50%, to $3.0 billion. Since consumer goods make up less than 5% of imports, any squeeze on purchases abroad would slow economic growth.

Turkey will be unable to boost exports as fast as last year because of increasing domestic requirements for agricultural goods and slower growth of output. Prices may again increase substantially but the best we expect

is a 25% hike in export earnings. Worker remittances, meanwhile, will not increase much, if at all, since West Germany is suspending recruitment of workers for the duration of the fuel crisis.

Given the outlook for imports, exports, and worker remittances, Turkey's current account balance is likely to swing from an estimated $400 million surplus in 1973 to a $300 million deficit in 1974. The deficit will not be extremely large compared with the country's foreign exchange reserves and will be partly covered by normal capital inflows. During 1972 nearly $600 million in official aid (including $145 million from the U.S.) was earmarked for Turkey. Approximately $450 million consisted of project aid and remains in the pipeline. Private foreign investment in Turkey amounted to $92 million in 1973. Debt service last year amounted to a manageable $167 million.

Chile

Higher oil prices will boost Chile's import bill by some $180 million. The estimated $235 million that Chile will have to pay for oil in 1974 equals about 20% of last year's export earnings. Because of the expected decline in world-wide demand for copper, financing this oil import bill will absorb an even larger share of 1974 export earnings.

The junta that replaced the Allende regime in September 1973 inherited an economy in shambles. Copper and agriculture, mainstays of the economy, had suffered serious production drops. Chile's balance of payments had deteriorated from a surplus of $123 million in 1970 to a deficit of $908 million in 1972. Despite continued deterioration through August, the 1973 balance-of-payments deficit declined to $255 million because of increased exports and large capital inflows after the military assumed power.

Even before the oil price hike, imports were expected to increase by at least 15% this year, because of growing requirements for food, industrial inputs, and copper mining equipment. Santiago had planned to more than offset this import rise by boosting copper production from 650,000 tons to as much as 800,000 tons. If copper prices slide as expected, however, Chile would have found it

difficult to balance its trade account even without a sharp rise in its oil import bill. A decline of 10 cents a pound on the world copper market represents a loss of $160 million in Chile's export earnings.

Under present circumstances, Chile will have to continue to rely heavily on foreign credit to finance its import needs. Despite a large foreign debt, its credit prospects appear good. Private US and Canadian sources already have extended some $200 million in short-term credit, and additional credits totaling some $450 million from Latin American neighbors are under negotiation. If copper prices fall sharply, Chile will seek larger foreign credits because it has no foreign exchange reserves to draw on.

Thailand

With high foreign exchange reserves and a good credit rating, Thailand could cover a likely $250-300 million increase in the costs of its petroleum imports in 1974. Nevertheless, a longstanding tradition of financial conservatism and the unsureness of a caretaker government probably will result in confused policies and uncharacteristic slowness in securing supplies. Moreover, the inflationary impact of higher oil prices will doubtless stimulate further public outbursts against the government.

Real growth in 1973 was probably about 5%, somewhat below the planned target. Most of this growth was due to a strong recovery in agricultural output from a weather-induced slump in 1972. Although a 40% jump in exports far exceeded the rise in imports, Thailand incurred a trade deficit of some $400 million last year. Exports in 1974 are expected to increase by about 10% but will fall far short of covering import costs, thus forcing Bangkok to draw on its estimated $1.1 billion in reserves. With no consumption cuts, Thailand's petroleum import bill alone in 1974 would total $550 million to $600 million, compared with $200 million in 1973. Conservation measures are likely to reduce these oil payments by about $100 million.



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Traditional Thai economic management has been geared to building up foreign reserces in pace with rising import requirements. In recent times, Thailand has maintained reserves of the equivalent of about 6 months' imports. Any substantial decline in this ratio has usually triggered sharp contractionary policies on the part of the government -- a pattern the current caretaker regime can be expected to follow. As a result, real growth in 1974 is unlikely to exceed 3% unless there is an exceptional improvement in weather conditions for the rice harvest.

Cambodia

Although Cambodia's support requirements for petroleum in 1974 could increase by $10-12 million if 1973 consumption levels* were unchanged, the crux of the problem in this country is simply getting the supplies into the Phnom Penh "garrison". Given the level of overall US aid for Indochina, some reduction in oil consumption from the 1973 level will be required. It could prove difficult to move even a reduced amount of oil to Cambodia, however, because of problems in lining up supplies and moving them up the Mekong.

The economic impact of reduced petroleum supplies is hard to project. Due to the effect of war, economic activity has declined drastically. Agricultural output may be down by 75% and industrial output by perhaps 50% since 1969. Exports have fallen to a trickle of pre-war volumes. Almost all types of commodities, including petroleum, are in short supply.

Cambodia clearly has no independent means with which to pay for such petroleum as can be delivered to it. The country in essence depends on US foreign aid as a source of both commodities and the bulk of foreign exchange at its disposal. US aid accounted for 90% of total foreign

* In 1973 Cambodia imported 1.8 million barrels of refined products.



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economic support in 1973. Moreover, it is becoming more difficult to enlist the support of other countries; Australia and Malaysia have both withdrawn from the foreign exchange support program.



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Philippines

The Philippines' oil import bill could increase by as much as $400 million in 1974. Total oil costs will reach around $600 million, equal to about one-third of last year's export earnings. Covering the higher costs will cause some strain on the country's foreign exchange position.

The Philippines will almost certainly experience a large trade deficit in 1974. We estimate that it will reach $250 million, compared with a $200 million surplus last year. Total imports will increase by at least 25%, to $1.9 billion, with practically all the rise reflecting higher oil import costs. Imports of machinery and equipment as well as intermediate goods are expected to fall somewhat because of an economic slowdown, but imports of grains will remain high.

Philippine export earnings in 1974 are likely to drop a little to about $1.6 billion -- partly because of expected weak foreign demand for certain commodities. Demand for copper remains strong for the moment, but this is likely to change as the year progresses because of economic downturns in major industrial countries. Demand for Philippine forestry products will weaken. About 40% of Philippine exports are food products, demand for which should remain strong.



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Manila can probably cope with the projected trade deficit without serious problems. The Philippines earn substantial amounts of foreign exchange from US military installations; these receipts will help to hold down the current account deficit. Assuming continuation of US and other foreign aid inflows at the $200 million level of recent years and a continued net inflow of private capital, Manila will not have to cut deeply into its foreign exchange reserves. Net foreign exchange reserves now total about $380 million, the highest level in many years.

South Vietnam

South Vietnam confronts a distinctive set of financial and resource constraints as a result of the petroleum price increases. For the last three years, global inflation has reduced the real resources flow into its economy. This year, constraints on the amount of US aid available for all of Indochina probably will require that the Vietnamese reduce petroleum consumption below 1973 levels. Both the real reduction in petroleum availabilities and the financial constraint of less real aid will keep investment depressed, and the result will be a third successive year of stagnation or decline in real output.

Under the new world prices, petroleum supplies in amounts to match 1973 would cost South Vietnam an additional $200 million. Such a figure is clearly beyond what can be supported by reduced aid availabilities for Indochina and flies in the face of American sentiment that US-aided economies should be required to make sacrifices comparable to our own. As a result, a more likely increase would be on the order of $75-100 million.

The Vietnamese do not possess any significant financial means for independent action in procuring oil supplies. Despite US import financing, foreign exchange reserves were drawn down about $50 million to a yearend 1973 level of about $170 million. Export earnings, while showing dramatic growth in 1972-73, cannot be expected significantly to exceed $100

million this year. Moreover, there are few alternative sources for comparable foreign assistance.

Reduced petroleum consumption during 1974 will have the greatest impact on the electric power industry, primarily in the Saigon area, and in the transportation sector. Highway transport now carries most of Vietnam's freight, including virtually all Saigon's food requirement: rice from the Delta, vegetables from Central Vietnam, and fish from the coasts. Shortages in this sector could create severe local supply problems and add to ongoing price rises for essential commodities. The agricultural sector consumes few petroleum products, but a related shortage of fertilizer could have a significant impact in farm output.